Woman C.P.A.

Volume 36 | Issue 4 Article 1

10-1974

Human Resource Accounting in Practice at R. G. Barry Corporation

Bertha Proffitt

Human Resource Accounting in Practice at R. G. Barry Corporation

Bertha Proffitt
Columbus, Ohio

From her first-hand knowledge the author explains an actual system of accounting for human resources.

Bertha Proffitt is General Accounting Manager for R. G. Barry Corporation. After working as a secretary for two years, she decided to move to Columbus and in her first interview, with R. G. Barry, she was given her choice of two openings: one in sales, one in accounting. She decided to take the job in the accounting department and has been with R. G. Barry now for 19 years – a record that speaks well of the Company's handling of its human resources.

Ms. Proffitt was selected to handle the Human Resource General Ledger when it was first established. Her article is based on her intimate knowledge of the Human Resource Accounting system used at R. G. Barry Corporation.

Ms. Proffitt is a member of the Columbus Chapter of the American Society of Women Accountants.

Over the years, much has been said and written about the fallacy of measuring only assets that have a physical tangible value or that can be reduced to cash while expensing outright the cost of building up a team of human beings that ultimately is responsible for the success of the business. Conventional thinking, the problem of deviating from the tax treatment of expenses for internal management purposes, SEC regulations, the inbred conservatism of accountants and many other considerations have delayed the accounting recognition of human resource values unduly long.

The Vital Ingredient

The importance of the human element in the operations of a business has long been acknowledged as evidenced by the many acquisitions and mergers that have been made primarily to obtain the management talent and the "team" of the acquired company or to take advantage of the goodwill built up by these people. Yet, this vital ingredient has always been left as an unidentified factor — after all, any fool could arrive at the conclusion that the more successful companies (among other things) probably had the better "brains".

The exception, the company that wanted to KNOW the value of its human resources, was R. G. Barry Corporation. It should be no surprise that the pioneer in the field of measuring human values came from the ranks of the apparel industry, since mechanization and automation have been extremely slow in that industry — hampered by frequent style changes and the small size of most companies. Therefore, labor — or people, if you will — represents a significant percentage of the manufacturing cost. The recognition of the central importance of people is manifested in the R.G. Barry Corporation's *Basic Purpose*: "(To) create a climate that stimulates, challenges and channels human intelligence, ingenuity and desire of our Associates to the fulfillment of our purpose and (to) provide them with a sense of achievement, equitable compensation, plus participation in the results of success".

In 1966, Gordon Zacks, President of R. G. Barry, contacted Dr. Rensis Likert at the Institute for Social Research, University of Michigan. Through Dr. Likert, the company was introduced to a team from the Institute headed by William C. Pyle, then its Director of Human Resource Accounting. Working together during the next 15 months, William Pyle, Professor Lee Brummet, Eric Flamholz and a top management team at R. G. Barry developed a system that would enable the company to account for its human resources. Figure 1 shows the flow of costs through the system as immediately expensed items or through asset accounts and, by way of amortization, back into the operating expense area.

At first, the system of Human Research Accounting (HRA) at R. G. Barry was limited to management personnel. In setting up the initial records, reasonable assumptions had to be made as to acquisition and development costs, but it is significant to note that these assumptions are still being used as "Standard Costs" (Figure 2). The "Beginning Balance Work Sheet" (Figure 3)

Figure 1

R. G. Barry Human Resource Accounting System for Investments in Managers (Outlay Costs)

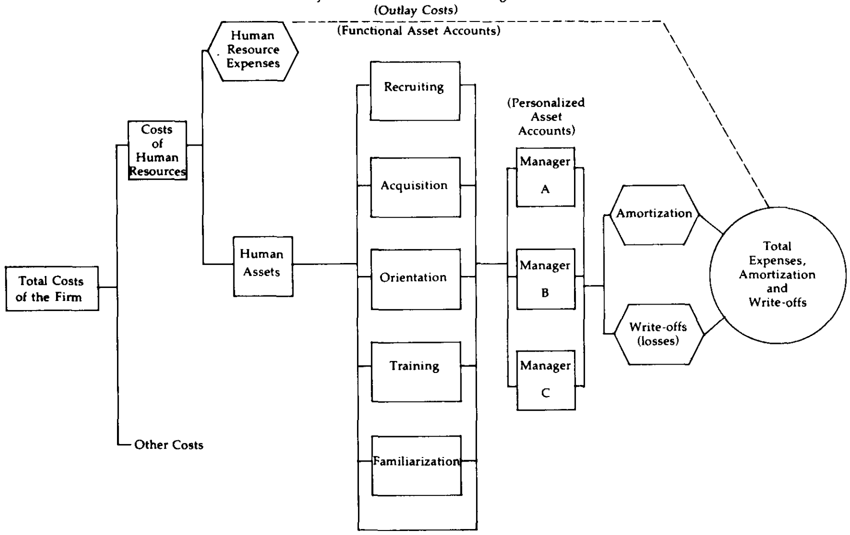


Figure 2

Master Standard Cost Table

Salary Grade	Recruiting	Acquisition	Orientation	Exit	Total
31	730	175	55	620	1,580
32	880	455	55	670	2,060
33	1,150	605	110	770	2,635
34	1,460	885	110	860	3,315
35	1,825	1,425	340	990	4,580
36	2,075	1,880	340	1,080	5,375
37	2,135	2,650	560	1,260	6,605
38	2,340	3,030	560	1,440	7,370
39	2,390	3,145	560	1,610	7,705
40	3,700	3,710	895	4,120	12,425
41	5,715	3,055	1,120	5,210	15,100
42	7,340	3,395	1,120	6,270	18,125
43	9,800	3,475	1,120	7,785	22,180
44	12,880	3,950	2,240	9,185	28,255

was developed. This very first form also is still being used. The next step was to determine a reasonable method of amortizing the investment in human resources. The "Expected Tenure Formula" was developed (Figure 4). The "Maximum Life Period" is, of course, the difference between the new employee's present age and age 65. The amortization period for management personnel is the Expected Tenure multiplied by the Maximum Life Period.

On January 1, 1968, R. G. Barry was ready to start its hand-posted ledger of Human Resource Accounting, consisting of the "costs" of 95 management employees. The information generated was reported to operating managers on a quarterly basis. Today, the management HRA ledger is still pretty much in the same form because of the confidentiality of much of the information contained therein, but now all the employees are included in the system, with the hourly paid employees' records being handled by computers. Since the nature as well as the scale of investments in factory and clerical personnel vary significantly from the human resource investments at the management level, the system for hourly-paid and clerical associates was limited to recording only acquisition, orientation and training costs. Also, the formula for determining the amortization period (Figure 5) differs somewhat from the Expected Tenure Formula for management personnel.

Capitalization vs. Immediate Expensing

It goes without saying that the criteria for capitalizing investments in human resources are no different from those used in the acquisition of fixed assets. An expenditure must reasonably be expected to benefit

Figure 3

Beginning Balance Work Sheet

Name: ________ Position: ________ Date of Hire: ____ Lifetime
Date of Birth: ____ Amort. Per. ____
Date Assumed Present Position: ________ Salary Grade: ____

ACCOUNT CLASSIFICATION	AMORTIZATION PERIOD	=	COST	−	AMORTIZATION	=	BEGINNING BALANCE
Recruiting	____	=	____	−	____	=	____
Acquisition	____	=	____	−	____	=	____
Orientation	____	=	____	−	____	=	____
Training	____	=	____	−	____	=	____
Familiarization	____	=	____	−	____	=	____
Formal Development	____	=	____	−	____	=	____
Informal Development	____	=	____	−	____	=	____
Exit	____	=	____	−	____	=	____
Other	____	=	____	−	____	=	____
TOTAL	____	=	____	−	____	=	____

the company over a longer period of time (usually in excess of 12 months) to qualify as a capital asset. Looking at the amounts that are customarily spent in the acquisition of personnel, there is no question that they are eligible if the expected "life" qualifies.

There are two different types of costs that are recorded: (a) direct costs, or out-of-pocket expenditures, such as advertising fees, placement fees, travel for the applicant, hotel bills, meals, outside testing, etc., and (b) allocated costs which are based on the time spent by the Human Resource Department and the Department Manager. The estimated time for all persons working on the recruiting and acquisition is multiplied by the midpoint of the salary range of the personnel involved to find the allocated cost figure. An allocation is made for the expenses incurred for interviewing persons that do not meet the requirements for the job or decide that they do not wish to accept the job.

The Functional Costs

The system consists of seven functional cost accounts:

1) *Recruiting.* This category comprises the cost of locating new personnel, money spent for advertising, travel expenses for interviewers and interviewees, etc. Internal as well as external recruiting costs are incurred for both successful and unsuccessful job candidates, while the balance of the functional human resource costs are limited to employees of the corporation.

2) *Acquisition.* The most prevalent expenses are placement fees, moving expenses, the cost of physical examinations, temporary living expenses and travel allowances until the family of the new employee can be relocated.

3) *Formal training and familiarization costs* are incurred in connection with formal orientation and training programs, which may be in-house or at another location. This type of cost applies to newly-hired employees as well as associates transferred from other departments.

4) *Informal training costs* are associated with the process of teaching new associates to adapt their skills to the new job.

5) *Familiarization costs* are truly hidden costs. They consist of the time required to learn the company's philosophy, objectives and understanding of the people with whom the new associate will interact. This can range from the first-day "How-do-you-do?" of the new hourly-paid factory worker to the many days spent by new managers in learning to know their "team" and finding the best way to motivate and supervise their employees.

Figure 4

Expected Tenure Formula: MANAGEMENT

Weights

Age Factor	= .50
Tenure Factor	= .25
Level Factor	= .25

PROBABILITIES

Age	*M/L*	*Tenure*	*M/L*	*Salary Level*	*M/L*
Up to - 25	.4	Up to 5 yrs	.5	31	.7
26 - 30	.5	6 - 10	.6	32	.6
31 - 35	.5	11 - 15	.7	33	.5
36 - 40	.5	16 - 20	.8	34	.5
41 - 45	.6	21 - 25	.95	35	.5
46 - 50	.9	26 - 30	.95	36	.6
51 - 55	.9			37	.6
56 - 60	.95			38	.8
61 - 65	.96			39	.8
66 - 70	1.00			40	.8
					.85
					.9
					.9

EXAMPLE: 27 yr. old; 3 yrs tenure; Salary Grade 32

Age	.5 x .5 = .25
Tenure	.25 x .5 = .125
Salary Grade	.25 x .6 = .150
	.525

For each person:

(Age Factor)	x .5 =
(Tenure Factor)	x .25 =
(Salary Factor)	x .25 = ______

Answer x Maximum Life Period

6) *Investment building experience costs* are related to on-the-job training which occurs after the initial familiarization period. They are expected to have value to the company beyond the current accounting period and hence "build" the investment in the new associate.

7) *Development costs* are incurred when a person attends a seminar or takes a course at a university. The costs collected in this category are the person's time spent away from the job, the seminar fees and expenses for travel, meals and lodging. The departmental managers are responsible for reporting any Development or Investment Building Experience costs incurred by any of their personnel.

The Effect on the Income Stream

Human Resource account balances are amortized annually based on the expected working life of the associate for all functional costs except training, which is amortized over a four-year life, and development costs, which have been assigned a six-year life. A particular development cost could be obsolete in a much shorter period of time, and if that occurs the manager instructs the Human Resource Department to write off the cost item at the end of the quarter in which it becomes obsolete. When associates leave the company, their accounts are written off entirely.

Starting in 1970, a "Human Resource Capital Plan" was developed for the use by managers. This plan enables them to compare their actual experiences as reflected on the quarterly reports with their expectations as far as investments and write-offs are concerned.

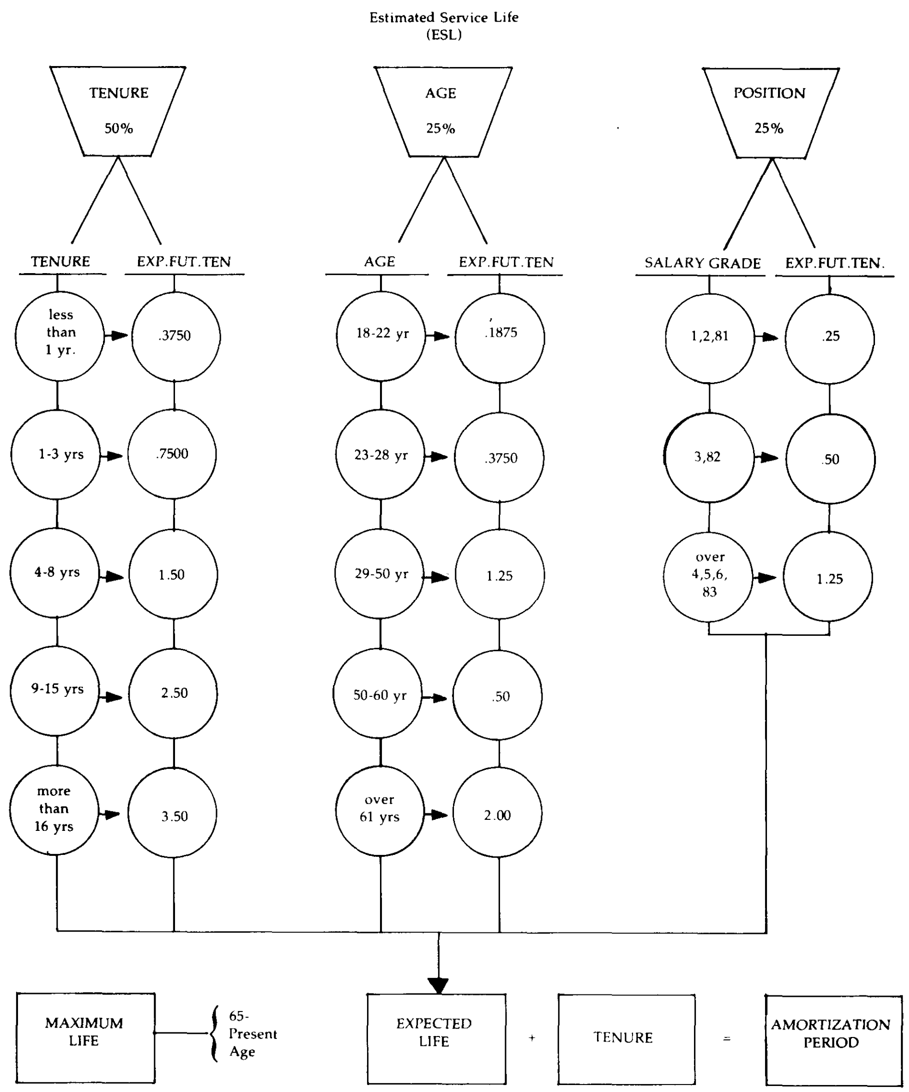
Hiring Procedures With Human Resource Costs in Mind

When a new position is created, or if a vacancy occurs because of separation or a promotion, the immediate supervisor sends a Request for Personnel to the Human Resource Department for action. The latter coordinates the recruiting and acquisition efforts with the divisional manager. The Human Resource Department also develops recruiting and acquisition cost standards for similar job classifications within the firm. The company has adopted the policy that all job openings must first be offered to associates before any outside recruiting can be done. In case of a management job, a notice is sent to all managers, and in the case of an hourly-paid position, the opening is posted on the News Center.

It goes without saying that in most instances associates of the company will be "cheaper" to acquire than outsiders. Their initial recruiting costs are already partially amortized, even though there would be an adjustment in the investment for the upgraded salary level if a promotion is involved. On the other hand, an associate may transfer to another department for personal reasons, and no adjustment may be required. This policy undoubtedly has many side-benefits, such as increased interest in the company on the part of associates and increased employee loyalty, since they can be assured that they will have first chance at promotion when openings occur.

Recognizing the human element of the business as having true economic value affects managerial thinking in many important ways, too. First of all, it cannot help but heighten the awareness of managers of the economic importance of people. Secondly, the human resource write-offs reflected in the quarterly reports highlight the fact that rapid personnel turn-over is costly. Thirdly, development of people takes on a different light when it is expressed in dollars-and-cents. Fourth, the income statement is really enhanced by reflecting the investment in, and the amortization and write-offs of human resource costs. Last, but certainly not least, a review of the human resource costs by department or other cost center, gives top management another opportunity to appraise the performance of the company's lower-level managers.

Figure 5



Effect on the Balance Sheet

So far, considerations have concentrated on the profit and loss area. Reflecting investments in human resources on the balance sheet does create problems. Regulatory agencies will not permit such practices, for tax purposes it would be undesirable to convert a presently deductible cost into a capital asset, and financial analysts and the financial press might label the practice of showing such investments as "padding" the balance sheet. The R. G. Barry Corporation has shown Human Resource Investments as a "line item" on their balance sheet with the sanction of their auditors. However, until this practice is more widely accepted, it will require a lot of disclosure and explanation.

Summary

Although still in its infancy and constantly developing, it can be said that accounting for human resources has already proved that it is a valuable management tool in the evaluation of performance and in the planning for the future and for expansion. It will, undoubtedly, become an accepted method of financial accounting at some future date, simply because the steadily increasing complexity of management requires the availability of ALL financial and economic data about the business. First-rate managers have a "feel" for their personnel situation, or they would not be where they are. But they deserve the aid of the tool that is designed to take much of the guesswork out of personnel decisions — the system of Accounting for Human Resources.